Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Petition of AT&T Inc. for Forbearance	)	WC Docket No. 07-21
Under 47 U.S.C. § 160 (c) From	)	
Enforcement of Certain of the Commission's	)	
Accounting Rules	)	
	)	
	)	
	)	

AT&T INC. REPLY COMMENTS

Theodore C. Marcus
Christopher M. Heimann
Jack Zinman
Gary L. Phillips
Paul K. Mancini

AT&T Inc.
1120 20th Street, NW
Suite 1000
Washington, DC 20036
(202) 457-2044
Its Attorneys

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AT&T Inc. ("AT&T") respectfully submits its reply comments in the above-captioned proceeding.

I. INTRODUCTION

AT&T is seeking forbearance from the Commission's cost accounting rules for the incontrovertible reason that, as a "pure" price cap non-rural carrier, neither the prices AT&T charges for regulated interstate or intrastate services are determined based on the underlying costs of providing service.[1] Thus, continuing to impose cost accounting requirements on AT&T

[1] Before the Commission are two forbearance petitions, the consideration of which has been synchronized into one docket. The first petition was originally filed by BellSouth Telecommunications, Inc. on December 6, 2005. *See Petition of BellSouth for Forbearance under 47 U.S.C. § 160 from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket No. 05-342 (Dec. 6, 2005). The latter petition was filed by AT&T on January 27, 2007. *See Petition of AT&T Inc. for Forbearance under 47 U.S.C. § 160 (c) from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket No. 07-21 (Jan. 25, 2007). Subsequent to BellSouth's filing, but before AT&T filed its petition, AT&T acquired BellSouth by merger. *See FCC Approves Merger of AT&T Inc. and BellSouth Corporation*, FCC News Release (Dec. 29, 2006). After the merger, AT&T withdrew BellSouth's petition and re-filed it for inclusion in the present docket. *See* Letter from T. Marcus to M. Dortch, WC Docket No. 05-342 (Feb. 9, 2007). Although each petition is addressed to the respective company's pre-merger operations and territory, they are substantively identical. Accordingly, the petitions are referred to herein as the "AT&T's petitions" or the "petitions", except when otherwise indicated. And, as indicated in AT&T's February 9, 2007 letter, AT&T hereby incorporates by reference herein the record –

is (i) not necessary to ensure that AT&T's rates are just and reasonable; (ii) not necessary for the protection of consumers; and (iii) not consistent with the public interest.[2]

The fundamental logic of this argument has been confirmed by the state members of the Federal-State Joint Board on Separations, who acknowledge that AT&T's status as a price cap carrier "eliminates" the role of cost allocation data in determining AT&T's rates, and "as a 'non-rural' company, AT&T's federal universal service support does not depend overtly upon separated costs."[3] Indeed, the state members candidly admit that AT&T "plausibly asserts that cost allocation rules, including Part 36, continue to impose very significant costs upon its operations."[4]

Despite the considerable disutility of continuing to apply the cost accounting rules to AT&T, some commenters nonetheless urge the Commission to deny AT&T's petitions. These commenters assert that there are ancillary uses for the cost data or future needs the data might address if certain hypothetical regulatory events take place. But an open-ended desire to collect cost data for speculative academic purposes cannot serve as a legitimate basis to maintain the Commission's cost accounting rules, particularly given the unwarranted burdens those rules impose on AT&T.

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particularly BellSouth's reply comments and other filings -- from the original BellSouth proceedings (WC Docket No. 05-342). In their comments, the State Members of the Federal-State Joint Board on Separations ask for clarification that the relief will only apply to the specified affiliates. Comments of the State Members of the Federal-State Joint Board on Separations ("Joint Board") at 13. AT&T clarifies here that the relief requested only extends to the affiliates specified in the petitions.

[2] *See* 47 U.S.C. § 160 (a).

[3] Joint Board Comments at 3.

[4] *Id*. at 4.

II. NEITHER THE COMMISSION NOR THE STATES WITHIN AT&T'S OPERATING TERRITORY USE ALLOCATED COST DATA TO SET AT&T'S PRICES.

Time Warner claims that the Commission and the state commissions within AT&T's operating territory "rely on cost accounting and ARMIS data to set rates under price caps."[5] The main premise of Time Warner's argument is that, because the Commission and the states relied on cost of service data *initially* to set rates under price caps years ago, the data should remain available to the regulators if/when price cap plans expire so that the regulators will be able to "investigate whether the ILEC's rates continue to be reasonable in light of its costs and overall productivity."[6] Time Warner's argument is deeply flawed and ignores the fundamental purpose of price cap regulation, the Commission's de-regulatory mandate under the Telecommunications Act of 1996, and the realities of the evolving telecommunications marketplace. The Commission should reject Time Warner's position summarily.

A. Congress Intended the Telecommunications Act to Result in De-Regulation, Not Re-Regulation.

The very purpose of the Telecommunications Act is the "reduc[tion of] regulation in order to . . . encourage the rapid deployment of new telecommunication technologies."[7] The Commission's price cap system,[8] though adopted six years before the Act, is consistent with the Act's de-regulatory commands as it migrated carriers from monopoly-era rate of return regulation to a more pro-competitive pricing regime. The price cap system "was designed to replicate some of the efficiency incentives present in competitive markets and to act as a

[5] Time Warner's Comments at 4.

[6] *Id*. at 5.

[7] *AT&T Inc. v. F.C.C.*, 452 F.3d 830, 836 (D.C. Cir. 2006).

[8] The price cap system "is intended (among other things) to improve the [carrier's] incentives to cut costs and refrain from overinvestment, incentives that are more blunted under the traditional [rate of return regulatory] method." *U.S.T.A. v. F.C.C.*, 188 F.3d 521, 524 (D.C. Cir. 1999).

transitional regulatory mechanism en route to full competition."[9] That is, after price caps "expire," the expectation should be that *competition* (*e.g.*, cable VoIP service, wireless voice and data services, competitive wireline service) will dictate service prices – not new regulations adopted by federal and state commissions, as Time Warner erroneously suggests. And, in fact, as competition flourishes, states are removing price cap regulation altogether.[10]

Further, the fact that the Commission used cost-of-service as a "starting point" for initializing price caps in 1990-91 does not mean that it would do so again in the future, or that it would need to perpetually maintain a source of fresh, embedded cost data in the unlikely event it decided to re-initialize price caps in the future. Such data may have been reference points to determine initial price cap formulae sixteen years ago, but they were replaced by inflation, demand and productivity as price-setting drivers on a transitional basis, to be replaced by competition in the long run.[11] As the Commission observed in adopting the CALLS Proposal in 2000:

> The CALLS Proposal is not designed as a permanent solution to all of the issues it addresses; instead, it is a transitional plan that moves the marketplace closer to economically rational competition, and it will enable us, once such competition develops, to adjust our rules in light of relevant

[9] *In the Matter of Petition for Waiver of Pricing Flexibility Rules for Fast Packet Services*, WC Docket No. 04-246, Memorandum Opinion and Order, 20 F.C.C. Rcd. 16,840, 18,848 (2005) (emphasis added). *See also Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, Sixth Report and Order, CC Docket Nos. 96-262 *et al.*, 15 F.C.C. Rcd. 12,962, 12,969 (2000) ("*CALLS Order*") ("Individual companies retain an incentive to cut costs and to produce efficiently, because in the short run their behavior has no effect on the prices they are permitted to charge, and they are able to keep any additional profits resulting from reduced costs. In this way, price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary").

[10] *See, e.g.*, AT&T Petition, Attachment 4 at 2, 5 and 10.

[11] To the extent that any "cost" data will be needed to monitor the effectiveness of the caps before competition fully is allowed to set prices, that data will certainly not be *ILECs' embedded costs*. Indeed, the *CALLS Order*, which Time Warner cites, provided price cap ILECs the option to submit cost studies "*based on forward looking economic cost* that [would] be the basis for reinitializing rates to the appropriate level." *See CALLS Order*, 15 F.C.C. Rcd. at 12,984 (emphasis added).

> market developments. Consequently, as the term of the CALLS Proposal nears its end, we envision that the Commission will conduct a proceeding to determine whether and to what degree it can deregulate price cap LECs to reflect the existence of competition.[12]

Inherent in Time Warner's argument is a forecast that the post-CALLS regulatory environment will head backward toward re-regulation, not forward toward de-regulation. The CALLS plan itself, which Time Warner extensively cites, thoroughly undermines its position.[13]

Thus, although the Commission and the states may have initialized price cap rates in reliance on rate of return regimes (*i.e.*, based on embedded, historical costs), it is plainly wrong to suggest that the Commission (or state commissions) would attempt to re-engage that process – from scratch – with the same caliber of data after price cap regulation has outlived its usefulness.[14]

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[12] *See CALLS Order* at 12,797.

[13] Sprint Nextel takes the regulatory need argument even further in claiming that, "by arguing that the Commission can rely on price caps, AT&T concedes that the market is not competitive." Sprint Nextel Comments at 9. And, Sprint Nextel continues, until an "effectively competitive market" emerges, the Commission will need the cost assignment data to ensure that rates are just, reasonable and non-discriminatory. *Id*. This is a preposterous argument, even for Sprint Nextel. If it is not already abundantly clear, AT&T does not concede any lack of competitiveness in the telecommunications market, and has made countless submissions to the Commission in this proceeding and elsewhere demonstrating the robust competition it faces from a multitude of competitors. By underscoring the logic of price caps and their elimination of the need for rate of return regulation cost data, AT&T is hardly suggesting that the market is not competitive. Rather, AT&T is merely pointing out that the path of de-regulation, which the Commission has diligently attempted to follow, does not lead to a reversal to rate of return regulation when the price cap regime ultimately comes to an end. Sprint Nextel's arguments to the contrary are frivolous.

[14] Indeed, such a retro-application of cost-of-service principles would clearly run afoul of the D.C. Circuit's admonition in *U.S.T.A.*, 188 F.3d 521. There, the Court opined that even a "second extensive reinitialization [of the 'X' factor productivity offset] would considerably aggravate perceptions [of regulatory policy inconstancy]," and, further, "[u]niversal, complete reinitialization would impair the supposed incentive advantages of price caps – which derive from firms' supposing that their efficiencies will *not* come back to haunt them." *U.S.T.A.*, 188 F.3d at 530 (emphasis in original). Time Warner's suggestion, which is wholly unsupported by Commission or other precedent, puts the Commission (and any state commissions) in precisely the situation the D.C. Circuit clearly forbade, *i.e.*, the dissolution of the very incentive advantages price caps were designed to provide, and a regulatory "gotcha" for those firms that properly assumed their "efficiencies would not come back to haunt them."

B. Switched Access X-Factor Reductions, Now Pegged to Inflation, Are Not "Tied" To Historic, Embedded, ILEC cost data.

Time Warner also mischaracterizes the *CALLS Order*'s effect on ILECs' price capped switched access rates as being "tied to ILECs' costs."[15] In *CALLS*, target rates for switched access usage charges, as discussed by Time Warner, were pre-determined by the Commission, and progress toward those rates was to be achieved through the application of an X-factor established solely for that reduction (and not, for example, as a productivity factor as per the price cap plan). Moreover, the switched access X-factor reductions were not "tied to ILECs' costs," as Time Warner intimates; rather, "total switched access *revenues* were used to calculate the size of the X-factor reduction."[16] After the pre-determined target rates for switched access services were reached, the X-factor for switched access was adjusted to GDP-PI (*i.e.*, inflation).[17] As the Commission noted, the "setting of the X-factor at GDP-PI would effectively freeze the price caps for the remainder of the term of the CALLS Proposal."[18] And this is precisely what has happened: the X-factor for switched access services has been frozen at inflation. Thus, contrary to Time Warner's claims, price cap ILEC cost data have no bearing on switched access rates.

C. The Pending *Special Access* Proceeding Provides No Justification for Denying AT&T's Petitions.

Time Warner, Ad Hoc and Sprint Nextel oppose the AT&T petitions on the grounds that the relief sought, if granted, would negate or compromise the Commission's ability to police

[15] Time Warner Comments at 6.

[16] *Id*.

[17] *CALLS Order* at 13,020-01.

[18] *Id*. at 13,021.

AT&T's special access rates.[19] Indeed, Ad Hoc, the most vocal opponent in this regard, contends that granting the Petition "would render the ongoing special access rulemaking meaningless."[20] Ad Hoc contends that ARMIS cost and earnings data establish that price-cap ILECs have exercised their market power to gouge consumers of special access services, and that elimination of that data will prevent the Commission from evaluating whether AT&T's special access rates are excessive.[21] Ad Hoc grudgingly concedes, as it must, that ARMIS may "misallocate[e]" costs, but claims that these misallocations are "minor" and "at the margins," and "do not affect the overall integrity of *trends* in data" because those misallocations do not "change from period to period."[22] Ad Hoc, thus, claims that ARMIS data is "a reliable and probative indicator of the BOCs' ability to increase prices to supracompetitive levels over a multi-year period without fear of competitive entry."[23]

Far from supporting retention of the cost accounting rules, these parties' claims emphasize the need for the Commission to eliminate obsolete regulatory requirements that no longer serve any legitimate federal regulatory purpose. In the *Special Access* and other Commission proceedings, AT&T and others thoroughly refuted claims by Ad Hoc and others that ARMIS cost and earnings data provide a reliable or probative basis for evaluating ILEC special access (or, for that matter, any other ILEC) rates; indeed, AT&T showed precisely the

[19] *See* Ad Hoc's Comments at 2 – 8; Sprint Nextel's Comments at 5; Time Warner's Comments at 7.

[20] Ad Hoc's Comments at 3 (citing *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulations of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM-10593, *Order and Notice of Proposed Rulemaking*, 20 FCC Rcd 1994 (2005) ("*Special Access Proceeding*" or "*Special Access NPRM*").

[21] *Id.* at 3, 5.

[22] *Id.* at 8.

[23] *Id.* at 9.

opposite.[24] AT&T will not fully reiterate here its arguments in those proceedings, which it incorporates by reference herein. Suffice it to say, however, ARMIS data are worthless as a tool for evaluating rates of return on (and thus the rates of) individual categories of interstate services like special access, as the Commission itself has acknowledged, because of the misallocation of costs and investments to different categories of services.[25]

These misallocations are anything but "minor" and "at the margins" as Ad Hoc claims.[26] In fact, these misallocations potentially involve billions of dollars for the BOCs.[27] Likewise,

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[24] *See* Opening Comments of SBC Communications Inc. filed in WC Docket No. 05-25, June 13, 2005, at 24-33; Reply Comments of SBC Communications Inc. filed in WC Docket No. 05-25, July 29, 2005, at 5-6, 35-38. *See also* Declaration of Alfred E. Kahn and William E. Taylor, On Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon, Exhibit 1 to Comments of BellSouth, in WC Docket No. 05-25, filed December 2, 2002, at 13, n. 49, and 6-7 (use of accounting profit rates … based on fully distributed costs to demonstrate that individual services are overpriced is economic nonsense" [and the cost allocations necessary to derive a special access rate of return] "render . . . the calculations meaningless"); Declaration of William E. Taylor, Ph.D., and Aniruddha Banerjee, Ph.D., NERA Economic Consulting, On Behalf of BellSouth Corporation, filed in WC Docket No. 05-25, November 8, 2004, at 13 (Ad Hoc's effort to analyze BellSouth's special access rates based on rate-of-return calculations using ARMIS data is "economically irrational," and cannot provide a basis for determining the profitability of special access services); Reply Declaration of Harold Furchtgott-Roth and Jerry Hausman, filed as Attachment 1 to BellSouth's Reply Comments, filed in WC Docket No. 05-25, July 29, 2005, at 17-18, in which the declarants observed that rate of return calculations using accounting allocations "make no economic sense," and that both the Federal Trade Commission and the Department of Justice have abandoned the practice in assessing market power

[25] *See* Declaration of David Toti on Behalf of SBC Communications Inc., filed in WC Docket No. 05-25, June 13, 2005, ¶¶ 3-5, 16-18, 42 ("Toti Initial Decl.").

[26] Ad Hoc Comments at 8.

[27] For example, while investment in Circuit Equipment grew $6.5 billion from 2000 to 2004, the freeze required SBC to apportion only $1.7 billion of this growth to the "Wideband" categories, the interstate components of which are assigned entirely to special access. *See* Toti Initial Decl. ¶ 34. An assumption that 50 percent of the growth in Circuit Equipment since 2000 should have been allocated to Wideband yields $1.1 billion of additional interstate special access investment. The result is even starker if one reasonably assumes that, but for the Freeze, increases in interstate special access costs as percentages of total costs subject to separations would have continued to keep pace (as they historically did before the freeze) with increases in interstate special access revenues as percentages of total revenues subject to separations: $1.5 billion of additional Circuit Equipment would have been allocated to interstate special access. *See id.* ¶¶ 35-36. Moreover, this is just one example; other cost allocations (of expenses as well as plant investment) would have to be recalculated in order to correct for the distortions caused by the freeze. *See* Reply Declaration of David Toti on Behalf of SBC Communications Inc., filed in WC Docket No. 05-25, July 29, 2005, at ¶ 10; Toti Initial Decl. filed in WC Docket No. 05-25 at ¶ 37; SBC's Opening Comments filed in WC 05-25 at 32.

there is no merit to Ad Hoc's claim that these misallocations "do not change from period to period" and thus do "not affect the overall integrity of *trends* in the data." Indeed, far from remaining constant, the misallocations have been growing significantly, since special access services have represented an ever-larger fraction of the BOCs' service mix. As time passes, moreover, the year-2000 allocation factors diverge ever further from reality, producing an ever-widening gulf between reality and ARMIS accounting data.

In the face of these facts, and the Commission's clear and repeated admonitions that ARMIS data cannot be used to calculate a multi-product provider's rate of return for a particular service, much less to assess the reasonableness of the provider's rate for that service, Ad Hoc and others continue to misuse that data to support their facile (and demonstrably incorrect) arguments about ILECs' purportedly astronomical regulatory rates of return for special access services, and the need to re-impose rigorous Commission oversight over those services. While their arguments, thus, are unavailing, their improper and inappropriate use of ARMIS data has forced the Commission and the industry to waste significant resources addressing the question of what, if any, conclusion may be drawn from that data – even though the Commission already has found that ARMIS data cannot be used on a service-specific basis. Thus, if anything, these parties' claims and repeated misuse of ARMIS data demonstrate why the Commission should eliminate obsolete regulatory requirements that no longer serve any legitimate federal regulatory purpose.[28]

[28] Time Warner's *Qwest Forbearance Order*-based arguments for keeping AT&T bound to the Commission's cost assignment rules are also unavailing. *See* Time Warner Comments at 17-18 (citing *Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules As They Apply After Section 272 Sunsets*, Memorandum Opinion and Order, WC Docket No. 05-333 (Rel. March 9, 2007) ("*Qwest Forbearance Order*"). Contrary to Time Warner's claims, the *Qwest Forbearance Order* is not inconsistent with the relief requested here because, unlike AT&T, Qwest remains subject to rate of return regulation in some of its states (Montana and Washington, for example). Nor is there any reason why accounting and cost allocation rules are

D. Federal and State Price Cap Regulation Leaves Cost Assignment Data on the Shelf.

Some commenters insist that the federal and state jurisdictions still need the cost assignment data for price cap functions.[29] This argument, which either conflates use with "need," or simply ignores the reality of how AT&T's prices are set, is demonstrably false.

The continuation of price caps does not, contrary to Sprint Nextel's contentions, "require the continuation of the cost assignment rules."[30] Only if the Commission (or a state commission) were to commit itself to a universal reinitialization of price caps would such a need potentially arise. AT&T is aware of no plausible scenario under which this would likely occur and, indeed, as the D.C. Circuit has made clear, such a plan would be suspect at its inception.[31] And, even on a theoretical basis, there would need to be a mountain of incontrovertible evidence to justify such a reinitialization. No such evidence has been presented in these proceedings (or elsewhere). It is highly irrational for the Commission to preserve the rules' applicability on such a non-existent showing.

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necessary to ensure compliance with 47 U.S.C. § 272 (e), the core issue in the *Qwest Forbearance Order* on this point. In any event, should AT&T ultimately be granted relief in its own effort to provide in-region, interstate, interLATA services on an integrated basis, which is separately before the Commission (*see* Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160 (c) with Regard to Certain Dominant Carrier Regulations for In-Region, Interexchange Services, WC Docket No. 06-120 (filed June 2, 2006)), AT&T certainly would be able to impute to itself, at applicable rates (*e.g.*, tariff, contract, *etc*.) "charges for access services used to provide interLATA services" consistent with 47 U.S.C. § 272 (e) (3). *See Qwest Forbearance Order* at ¶ 67. The maintenance of the elaborate and pervasive blanket of regulations at issue in the instant AT&T petitions would constitute a substantially overbroad method of ensuring section 272 (e) compliance.

[29] *See* Sprint Nextel Comments at 9-10; Time Warner Comments at 11-12; Comments of the Nebraska Rural Independent Companies ("NRIC") at 2-4.

[30] Sprint Nextel Comments at 9.

[31] *See U.S.T.A.*, 188 F.3d at 530 ("Universal, complete reinitialization [of price caps] would impair the supposed incentive advantages of price caps – which derive from firms' supposing that their efficiencies will *not* come back to haunt them") (emphasis in original).

Similarly, the productivity 'X'-Factor (*i.e.*, not the factor discussed with respect to the CALLS Plan) is not dependent upon continued availability of the cost assignment data, as Sprint Nextel incorrectly argues. The 'X'-Factor's calculation methodology is based on "total factor productivity," which is a ratio of an index of total outputs (*i.e.*, all LEC services produced) to total inputs (*i.e.*, labor, capital services and materials).[32] Thus, TFP (and, hence, the 'X'-Factor) is based on *total company productivity*, and not productivity restricted to interstate access services, or restricted to regulated services. Moreover, the FCC has expressly determined that it will not measure TFP on any other "less-than-total-company basis," *e.g.*, on a regulated services only basis.[33] As AT&T has repeatedly maintained, its total company cost data (*i.e.*, the Part 32 chart of accounts) will remain available if forbearance is granted.

Further, exogenous adjustments, described by Sprint Nextel[34] and listed in the current price cap rules (*i.e.*, adjustments due to separations changes, and adjustments due to the Commission ordering reallocation of investment from regulated to non-regulated activities), present no stumbling block to the requested relief. As AT&T explained in its Petitions, exogenous adjustments brought about by changes to the Part 36 separations manual, as a practical matter, have been mooted by the long-standing separations freeze. And, should AT&T's forbearance petitions be granted, it will no longer have any basis for seeking exogenous relief for investment reallocation, which renders that issue moot as well.[35]

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[32] *See In the Matter of Price Cap Performance Review for Local Exchange Carriers*, Fourth Report & Order, CC Docket Nos. 94-1 and 96-262, 12 F.C.C. Rcd. 16,642**,** 16,679 (1997), *aff'd in part, rev'd in part, U.S.T.A., supra*, 188 F.3d 521 (1999) ("*Fourth Report & Order*").

[33] *See Fourth Report & Order*, 12 F.C.C. Rcd. at 16,686.

[34] Sprint Nextel Comments at 11.

[35] *See* BellSouth Petition at 50.

Also, Time Warner dedicates an inordinate portion of its comments to the argument that there is a "strong connection between AT&T's federal and state regulated rates" and AT&T's costs and, thus, there will be a continuing need for the Commission to ensure that AT&T cannot engage in cost-shifting and similar misallocations, and thus "protect consumers against the distortions and inequities of cross-subsidy." Time Warner simply has not been paying attention.

It may very well be appropriate for the Commission to maintain its cost assignment rules for carriers whose rates are, in fact, determined *via* rate of return regulation. Whoever those carriers are, however, AT&T is clearly not one of them. Whatever incentives there may be for a rate of return carrier to manipulate costs (*i.e.*, to shift costs to ratepayers from unsuccessful non-regulated activities, or to engage in price squeeze activity against competitors who buy inputs from the carrier in order to compete, *etc.*), those incentives have been eliminated in AT&T's case through the adoption of pure price caps. And, because AT&T is regulated by price caps, the rate of return era accounting rules – which do not set prices for AT&T – do not address the activities about which Time Warner warns. Thus, even if Time Warner could establish a basis for its concerns -- which it certainly has not in its submission – it proposes an irrational solution to address those concerns.

With respect to states that continue to regulate carriers operating within their borders under rate of return regulation, their regulatory functions will not be affected by the granting of the relief sought herein, either because AT&T does not provide intrastate regulated services in those states, or because AT&T's petitions expressly exclude the state from the scope of the requested relief. Thus, the removal of the AT&T allocated cost data from the separations issue

matrix now under Joint Board consideration should have no practical regulatory effect on any state, whether within or outside of AT&T's post-merger operating territory.[36]

The Nebraska Rural Independent Companies ("NRIC") have contested this assertion in their Comments, claiming that certain states in AT&T's operating territory (Oklahoma, Illinois, Nevada and Wisconsin) have some requirements for state-specific data derived from the Commission's cost allocation rules.[37] NRIC properly points out that there are a few legacy monitoring and rate of return requirements applicable to AT&T in those states. Although AT&T's petitions do not seek complete relief from ARMIS, it is correct that some of the data that would ordinarily populate certain ARMIS or similar reports would no longer be available if relief is granted. However, the state functions that the NRIC claims would be affected by the granting of relief are not rate-setting functions. Indeed, none of the states, as demonstrated fully in the petitions, uses allocated, state-specific cost data to set AT&T's prices.

Those regulatory functions that remain, thus, are not tied in any way to the core purposes of the rate of return rules (rate-setting, prevention of cost misallocation and cross-subsidization that would harm ratepayers and competitors, *etc*.): those purposes have been fully and adequately addressed in the state price cap formulas and operations. Moreover, AT&T data from the Part 32 chart of accounts (*i.e*., total cost data) will remain available should relief be granted, as will information on AT&T's revenues and earnings, which are publicly reported. There is no reason to believe that the state regulatory operations that NRIC seeks to safeguard (*e.g*., state-to-state comparisons of operating results – NRIC Comments at 3) cannot perform properly and

[36] In any event, all of the states with intrastate regulatory operations that even theoretically might be affected by the requested forbearance are fully engaged in the Separations Joint Board proceedings and, to the extent those states feel a need to protect their positions in those proceedings here, it is reasonable to expect that they can and will do so.

[37] *See* NRIC Comments at 2-3.

adequately on the basis of the large volume of cost and financial information that will remain available if forbearance is granted.[38]

III. THE COST ASSIGNMENT RULES ARE NOT NECESSARY FOR THE FULFILLMENT OF THE COMMISSION'S UNIVERSAL SERVICE OBLIGATIONS.

Some commenters assert that universal service will be negatively impacted by the granting of the AT&T petitions. These concerns are misplaced and should be rejected.

NRIC claims that the "cost allocation rules and jurisdictional separation rules provide information to ensure that the requirements of Section 254 (k) are met."[39] NRIC further contends that AT&T incorrectly asserts that price cap regulation is sufficient to meet the requirements of 254 (k). NRIC also states that "while price cap regulation may limit a carrier's ability to increase prices, it generally does not prohibit a carrier from increasing prices to offset revenue losses from decreasing prices of non-regulated services."[40]

Section 254 (k) prohibits a carrier from using services that are not competitive to subsidize services that are competitive. Additionally, it requires the Commission, through the establishment of any necessary cost allocation rules, accounting safeguards, and guidelines, to ensure that services included within the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.[41] The notion that an express "prohibition" is needed to prevent a carrier from incrementally

[38] In this vein, it should be noted that Oklahoma, Nevada and Illinois – specifically referenced by NRIC for their regulatory accounting requirements (*see* NRIC Comments at 3) -- have not filed oppositions to the AT&T petitions, and Wisconsin -- which has filed comments -- did not expressly oppose the petitions on the merits. However, as AT&T stated in its petitions, AT&T expects that it will work with the state commissions in its in-region territory to address state needs.

[39] NRIC Comments at 5.

[40] NRIC Comments at 5.

[41] 47 U.S.C. § 254 (k). *See* BellSouth Petition at 55.

increasing its price-capped rates (*i.e.*, within the limited range provided by the *caps*) to offset revenue shortages in non-regulated services, however, is a curious one. If, as NRIC concedes, AT&T, as a price cap carrier, has only "limited ability" to raise prices for price capped services due to the strictures of API (actual price index), PCI (Price Cap Index) and SBI (Service Band Index),[42] then it strains credulity to believe that such capped pricing flexibility presents a wide-open opportunity for AT&T to manipulate prices *within the caps* to offset losses in services not subject to caps.

Further, whatever opportunity is presented by this pricing flexibility should not be cause for alarm. First, the fact that a price cap carrier charges the prices allowed under the caps is *per se* legitimate. There is no super-imposed standard that price cap carriers under pricing flexibility may not charge the prices permitted under the caps. To the contrary, such carriers are fully permitted (and presumably expected) to charge those prices that make the most economic sense to the carriers. If the market would bear prices at the cap, AT&T should set its prices at the cap regardless of the success or failure of its other regulated or non-regulated services. If AT&T sets its prices too high, competitors will come in and take customers away.

Moreover, the ability to charge prices within the confines of pricing flexibility is hardly without limits, by definition. Cap restrictions as well as intermodal and intramodal competitive alternatives ensure that the pricing decisions of a price cap carrier, such as AT&T, are suitably

[42] *See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of US West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket Nos. 96-262, 94-1, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14,221 at 14,227-29 (1999) ("*Pricing Flexibility Order*) ("These pricing bands give price cap LECs the ability to raise and lower rates for elements or services as long as the actual price index (API) for the relevant basket does not exceed the PCI for that basket, and the prices for each category of services within the basket are within the established pricing bands. Together, the PCI and pricing bands restrict a price cap LEC's ability to offset price reductions for services that are subject to competition with price increases for services that are not subject to competition").

restrained.[43] As the Commission observed in the *Pricing Flexibility Order*, Phase II relief, which "allows LECs to raise and lower rates," can only be obtained upon a demonstration "that competitors have established a significant market presence in the provision of the services at issue."[44] The presence of such established competitive alternatives to the ILEC's services, the Commission correctly concluded, "will ensure that rates are just and reasonable."[45] Thus, in those areas in which AT&T has obtained the pricing flexibility of which NRIC now complains, the Commission's price cap regime fully manages those issues without any continuing use or need of the cost allocation rules.

IV. OTHER ANCILLARY USES ARE INSUFFICIENT TO JUSTIFY CONTINUED IMPOSITION OF THE COST ASSIGNMENT RULES.

In their comments on AT&T's petitions, several commenters raised questions about the impact on ancillary issues and alleged regulatory "needs" should AT&T's petitions be granted. None of these issues warrants denial of the petitions.

A. States' Abilities to Oversee Transactions with Affiliates Will Not Be Impaired.

The Wisconsin Commission raised a concern about its ability, and potentially the ability of other states, to fulfill their obligations to oversee affiliate transactions.[46] Even though AT&T's accounting of affiliate transactions no longer has any impact on prices, AT&T recognizes that, unless and until the Wisconsin law is changed, the Wisconsin Commission still

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[43] *See In the Matter of Petition for Waiver of Pricing Flexibility Rules for Fast Packet Services*, 20 F.C.C. Rcd. at 16,849 ("The policy underlying Phase I pricing flexibility is to allow incumbent LECs to respond to competition as it develops, *while at the same time using the price cap mechanism to guard against unreasonable rate increases for those customers that do not yet have competitive alternatives*") (emphasis added).

[44] *Pricing Flexibility Order* at 14,258.

[45] *Id*.

[46] Comments of the Public Service Commission of Wisconsin ("Wisconsin Commission") at 3.

has an obligation to oversee affiliate transactions. The ability to carry out that obligation will not be impaired by granting AT&T's petitions, however. If AT&T's petitions are granted, AT&T will still remain obligated, pursuant to Generally Accepted Accounting Principles ("GAAP"), to account for transactions with affiliates.[47] Thus, the Wisconsin Commission will still have a sufficient basis to carry out its oversight obligations.

B. Future Confiscation Claims Do Not Present An Issue.

In their comments, the Wisconsin Commission and the State members of the Joint Board contend that, as an adjunct to the forbearance relief, if granted, AT&T should be required to waive any future confiscation claim(s) it might otherwise wish to make due to a lack of competent proof (*i.e.*, because allocated, separated cost data upon which to judge such claims would be unavailable).[48] Such a demand for waiver is both unprecedented and unwarranted. There is no basis – and forbearance certainly should provide none -- for requiring a price cap ILEC to waive constitutional rights in order to pursue *statutory remedies* otherwise available to it. The suggestion of some to the contrary is unsupportable.

Second, those advocating such a requirement fail to explain their rationale for doing so. It is well-known that, as a matter of law and procedure, a carrier has the burden of proof when bringing an action for unconstitutional confiscation of property.[49] Although a price cap ILEC raising a confiscation claim may find it more difficult to prove such a claim without separated cost data, that fact alone should not justify *eliminating* the carrier's right to bring the claim in the first place with whatever data it may have. The commission or court reviewing the claim will

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[47] For discussion, *see* BellSouth Petition at 65-70.

[48] Joint Board Comments at 9; Wisconsin Commission Comments at 3-4.

[49] *See Chesapeake & Potomac Telephone Co. of Baltimore City v. West,* 7 F.Supp. 214, 217 (D. Md. 1934).

assign the cost data whatever weight it deserves. Thus, whether or not the data is developed using the jurisdictional separations requirements is unimportant, given that the ILEC ultimately has the burden of proving its confiscation claim.

C. AT&T Need Not Waive Any Right to a Low End Adjustment.

Some commenters imply that AT&T is being disingenuous in its requests, and would rush to request upward adjustments in its price caps if its earnings fall below some threshold.[50] Without allocated cost data, they argue, such a low end adjustment cannot properly be considered and, thus, should not be permitted. This is a red herring.

AT&T, like most (if not all) price cap ILECs, has obtained Phase I pricing flexibility (*i.e.*, has given up the right to any low end adjustment in *all* areas). This means that AT&T is already required to forego any right to a low end adjustment for under-earnings in any given period.[51] As a result, placing such a condition on AT&T in order to receive forbearance would be superfluous.

D. Allocated Cost Data Is Not Needed for the Rural High Cost Fund.

Sprint Nextel argues that "cost data are used to set high cost loop support levels for rural carriers."[52] This argument is misleading. Part 36.611 (a) – (g) requires each LEC to provide NECA certain unseparated (regulated) cost data by study area for use in determining expense adjustment amounts for rural LECs. The information has historically been required from all carriers so that NECA could calculate national average unseparated loop costs for use in computing expense adjustment amounts for rural LECs. However, per Part 36.622 (a), effective

[50] *See* Sprint Nextel Comments at 14; Ad Hoc's Comments at 6; Time Warner's Comments at 29.

[51] *Pricing Flexibility Order*, 14 FCC Rcd at 14,307 ("[a]ny LEC obtaining Phase I regulatory relief in any MSA will be *precluded from making any low-end adjustment throughout its entire, holding-company-wide, service region, regardless of whether it files separate tariffs for each of its study areas*") (emphasis added).

[52] Sprint Nextel Comments at 20.

July 1, 2001 the national average unseparated loop cost for purposes of calculating expense adjustments for rural LECs *was frozen at $240*.[53] Thus, although NECA continues to "collect" national average loop cost data, actual cost data resulting from the rules' application is not being used by NECA for these purposes and is not anticipated to be used in the foreseeable future.

V. REFERRAL TO THE SEPARATIONS JOINT BOARD OR OTHER FEDERAL-STATE JOINT BOARD IS UNWARRANTED.

Some commenters recommend that the Commission forego deciding the merits of AT&T's petitions and, instead, refer AT&T's petitions for consideration either by the Separations Joint Board or some other yet-to-be impaneled federal-state joint board. Such a forum, they argued, would be better suited to defining and analyzing the impact of forbearance in both jurisdictions.[54] Although Joint Board and State Commission input is obviously not to be barred or ignored, the Commission should reject these recommendations for the following reasons.

A. A Joint Board Referral Does Not Excuse the Commission from Its Statutory Obligation to Rule on a Forbearance Petition.

AT&T's forbearance petitions were filed pursuant to section 10 of the Act, which imposes an express, mandatory duty upon the Commission to rule upon the petitions.[55] As the Commission has been repeatedly reminded by the courts, "Congress enacted section 10 as a 'viable . . . means of seeking forbearance' from regulation, and the Commission has 'no

[53] *See* 47 C.F.R. § 36.622 (a).

[54] *See* Comments of the Texas Office of Public Utility Counsel at 2; Wisconsin Commission Comments at 1-2; Comments of the New Jersey Department of the Public Advocate (referencing the Comments of its predecessor -- the New Jersey Ratepayer's Advocate -- previously filed in WC 05-342) at 3; Comments of the National Association of State Utility Consumer Advocates ("NASUCA") at 3; Joint Board Comments at 5-6; Sprint Nextel Comments at 3, 6-7; Time Warner Comments at 19, n. 44.

[55] 47 U.S.C. § 160 (c). *See AT&T Corp. v. F.C.C.*, 236 F.3d 729, 738 (D.C. Cir. 2001) ("Congress has established § 10 as a viable and independent means of seeking forbearance. . . . Section 10 broadly states that the Commission *will* forbear from applying any regulation or any provision of the Act to a telecommunications carrier . . . if certain statutory determinations are made") (emphasis added).

authority to sweep it away' on the grounds that it would prefer to determine the appropriate regulatory treatment . . . through a different mechanism."[56] Further, the "'availability of . . . an alternative route for seeking [forbearance] does not diminish the Commission's responsibility to fully consider petitions under [section] 10.'"[57] Thus, contrary to some commenters' suggestions, referring AT&T's petitions to a joint board would in no way enable the Commission to avoid its clear duty to rule on the petitions by the statutory deadline.

In addition, at least one commenter appears to be laboring under the mistaken impression that a referral to the Separations Joint Board is mandatory under section 410(c) of the Act.[58] Section 410(c)'s mandatory referral clause, however, is limited to a "notice of proposed rulemaking" that is "institut[ed]" by the Commission.[59] All other referrals under section 410(c) are discretionary (*i.e.*, the Commission "may" make such referrals). The instant proceeding, which involves two forbearance petitions, is *not* a Commission-instituted NPRM on separations for which a Joint Board referral might otherwise be mandatory. Thus, the mandatory referral provisions of section 410(c) simply do not apply.

B. Referral Is Unnecessary to Obtain the Input of the Joint Board and the States.

Even without a formal referral, this Commission has already received significant input from the Separations Joint Board and state commissions that is relevant to AT&T's petitions.

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[56] *AT&T Inc. v. F.C.C.*, 452 F.3d 830, 836 (D.C. Cir. 2006) (quoting *AT&T Corp. v. F.C.C.*, 236 F.3d at 738).

[57] *AT&T Inc. v. F.C.C.*, 452 F.3d at 836 (quoting *AT&T Corp. v. F.C.C.*, 236 F.3d at 738).

[58] *See* Wisconsin Commission Comments at 1-2.

[59] Section 410 (c), 47 U.S.C. § 410 (c) establishes, and governs the referral of proceedings to, the Federal-State Joint Board. Section 410 (c) provides that the Commission "shall refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations, which it institutes pursuant to a notice of proposed rulemaking and, except as provided in section 409 . . . may refer any other matter, relating to common carrier communications of joint Federal-State concern, to a Federal-State Joint Board." 47 U.S.C. § 410 (c).

For example, on May 1, 2006, the Separations Joint Board filed a paper in Docket No. 80-286[60] titled *Post-Freeze Options for Separations*. In that paper, while still reluctant immediately and totally to eliminate separations rules, the Joint Board acknowledged that carriers "on price caps regimes are obvious candidates to be exempted from separations because of competition."[61] Similarly, in their August 22, 2006, comments on the FCC's NPRM on Separations Reform, several state commissions recommended an egress "for incumbent carriers [from] their separations obligations."[62] The states, thus, have recognized already the logic that underlies the instant petitions in the very proceedings to which some commenters wish the present matters to be referred. That "input" should not be ignored now.

In addition, it is a stretch to conclude, as Time Warner has, that the states are unaware of the pending petitions, or that the Commission would somehow be deprived of important input from the states on the issues presented if it were to grant relief here.[63] In fact, as is clear from the comments that have been presented in this proceeding and in the prior BellSouth proceeding, the states (including state-sanctioned consumer advocates) have participated in this proceeding and have provided input on the issues. Their participation demonstrates that a formal referral to a Joint Board is not necessary to get state input in this proceeding.

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[60] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Order and Further Notice of Proposed Rulemaking, 21 F.C.C. Rcd 5516 (2006).

[61] Letter from J. Ramsay to M. Dortch, CC Docket No. 80-286, May 1, 2006.

[62] *See, e.g.*, Comments of the Idaho Public Utilities Commission in *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, filed August 22, 2006 at 8. The "exit ramp" would require the following: (1) a carrier's assertion that its rates are deregulated in the state jurisdiction; (2) the carrier's waiver of rights to subsequently claim an unconstitutional confiscation of its property; (3) state commission statement that it has no current or anticipated future use for separations results; (4) the Commission's determination of how USAC will calculate universal service payments after opt-out for that carrier and for other competing carriers serving the same area; and (5) the Commission's determination that universal service programs can operate satisfactorily without any separations data inputs from that carrier.

[63] *See* Time Warner's Comments at 19, n. 44.

And, of all the states within AT&T's local exchange operating territory to which AT&T's petitions would apply, none has directly opposed the petitions to date. Indeed, thus far, only Wisconsin has filed comments in the present proceedings, in which the Wisconsin Commission neither supported nor opposed the AT&T petitions but, rather, expressed a desire for the Commission "to refer this important matter to the Joint Board on Separations**."**[64]

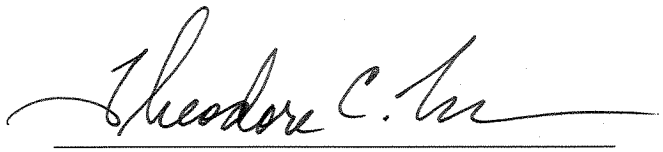
Finally, there is no cause for the alarm sounded by some commenters that, without referral to a Joint Board, the forbearance – if granted – will have a disruptive effect on separations proceedings and a negative impact on states even before separations are finally and fully resolved in those proceedings. As AT&T has made clear – and no one disputes – all of the states in the operating territory that *would be covered by the requested relief* regulate AT&T's service prices *via* incentive regulation (*e.g.*, price caps). These states do not use allocated, separated cost data in their price cap formulae to set AT&T's prices, and have not indicated – certainly not publicly – a desire to re-institute rate of return regulation. And, to the extent that any of these states might take issue with AT&T's petitions, they are well aware of the present forum for the presentation of those views.

[64] *See* Wisconsin Commission Comments at 5. Also, on the day AT&T withdrew the BellSouth petition, *staff* of the Florida Public Service Commission ("FPSC") filed an *ex parte* expressing "concerns" about BellSouth's petition and inserting comments from other un-related proceedings onto the record of WC 05-342. The Florida Commission, however, has not opposed the petitions. Moreover, FPSC staff engaged in discussions with AT&T to alleviate the "concerns" that were raised in the February *ex parte* (which mainly had to do with evidentiary requirements in future storm cost recovery proceedings).

VI. CONCLUSION

For the foregoing reasons, and for the reasons provided in AT&T's petitions, the Commission should grant the relief requested in those petitions.

Respectfully submitted,



Theodore C. Marcus
Christopher M. Heimann
Jack Zinman
Gary L. Phillips
Paul K. Mancini

AT&T Inc.
1120 20th Street, NW
Suite 1000
Washington, DC 20036
(202) 457-2044
Its Attorneys

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